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CHARLES ELMORE CROPLEY

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1930.

No. 124.

THE FIRST NATIONAL BANK OF CHICAGO, *Plaintiff*,

*v.*

THE UNITED STATES.

**On Writ of Certiorari to the Court of Claims of the United States.**

## MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF.

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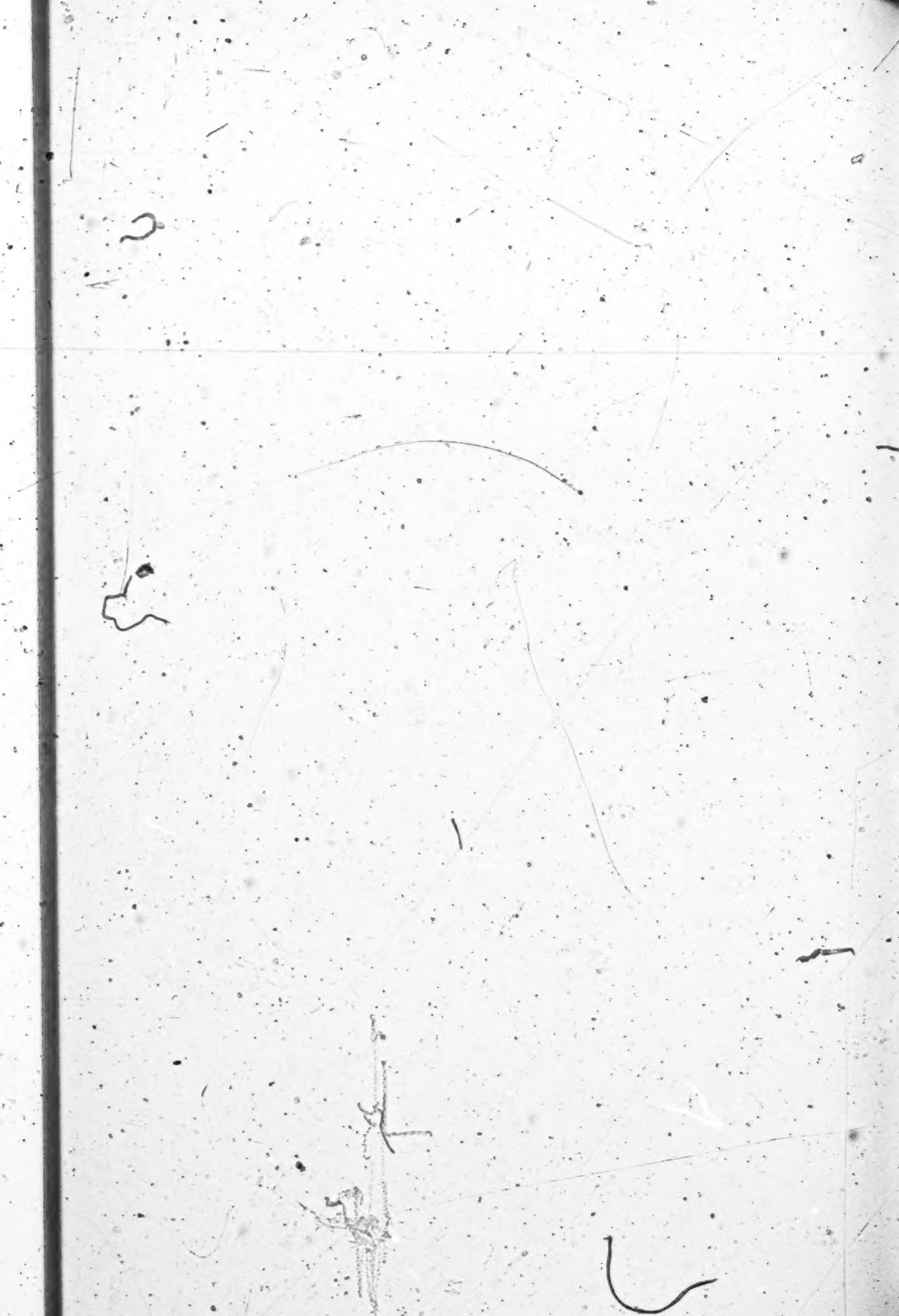

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## MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF.

May it Please the Court:

The undersigned respectfully moves this Honorable Court for leave to file a brief in this case as amicus curiae.

JOHN E. MCCLURE,
922 Southern Building,
Washington, D. C.,
*Attorney for Bank of Commerce & Trust Company.*

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No. 124.

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THE FIRST NATIONAL BANK OF CHICAGO, *Plaintiff*,

*v.*

THE UNITED STATES.

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## BRIEF ON BEHALF OF BANK OF COMMERCE & TRUST COMPANY AS AMICUS CURIAE.

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The *Bank of Commerce & Trust Company* of Memphis, Tennessee, has pending before the Income Tax Unit the question relating to the deductibility of interest paid by joint stock land banks on joint stock land bonds, the proceeds of which were used to make mortgage loans to farmers. We have been advised that the determination of our question will be deferred until the decision by the Supreme Court in *First National Bank of Chicago, Plaintiff vs. United States.*

## Opinion Below.

The opinion of the Court of Claims is reported in 69 Ct. Cls. 312.

## Jurisdiction.

The judgment to be reviewed was entered March 3, 1930, and this case is before this court by virtue of an order entered June 2, 1930, granting plaintiff's petition for a writ of certiorari to the Court of Claims of the United States.

## Question Presented.

The single issue is whether or not a joint stock land bank may, in computing its net income under the Revenue Act of 1921, deduct the interest paid on its bonds, the proceeds of such bonds being used to make loans to farmers on farm mortgage securities.

## Law Involved.

Section 213, Revenue Act of 1921, provides that the term gross income does not include:

> "(4) Interest upon * * * (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916;"

Section 234, Revenue Act of 1921, provides that, in computing the net income of a corporation subject to the tax imposed by Section 230, there shall be allowed as deductions:

> "(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or

carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer), the interest upon which is wholly exempt from taxation under this title;"

Section 26 of the Federal Farm Loan Act (39 Stat. 360, 380) provides in part as follows:

"First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of the Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal and local taxation."

## Statement.

A full statement of the facts is set out on pages 2 to 5, inclusive, of the plaintiff's brief which, succinctly stated, shows that during 1922 the joint stock land banks paid interest of $72,997.55 on their bonds, the proceeds of these bonds having been used to make loans to farmers on farm mortgage securities, each loan being made in consideration of the executing and delivering by the respective farmer of a mortgage. The taxing authorities disallowed the interest paid as a deduction from gross income.

## Summary of Argument.

In passing the Federal Farm Loan Act it was the intention of Congress to encourage agricultural development and assist farmers to borrow money secured by first mortgages on their farms. To this end Congress specifically provided in Section 26 of the

Federal Farm Loan Act that the income from the first mortgages should be exempt from any and all taxation. The exemption from taxation is contained in the Federal Farm Loan Act itself and not in the Revenue Act of 1921. The Revenue Act of 1921, Section 213 (b)(4)(b), exempts from taxation "securities issued" under the Federal Farm Loan Act, and obviously a "mortgage executed" does not fall within the category of "securities issued". The words "securities issued", as contained in the exemption provision of the 1921 Act, are to be applied as that term is ordinarily used. Furthermore, Congress, in declaring the first mortgages to be instrumentalities of the government of the United States, intended that such mortgages should, for taxation purposes, be treated the same as if they were obligations of the United States.

## Argument.

An examination of the brief filed by plaintiff indicates no necessity on our part for a repetition, hence we confine this brief to the following points which we seek to stress:

### Congress had a Definite Purpose in Mind in Exempting from Taxation the Income derived from First Mortgages executed under the Federal Farm Loan Act.

The legislative history of the Federal Farm Loan Act (39 Stat. 360) discloses an intention by Congress to encourage agricultural development by enabling farmers to borrow money secured by first mortgages on their farms, and providing that such farmers would

pay only a reasonable rate of interest on such loans. The mortgages and farm loan bonds are the very essence of the Act. *31 Op. Atty. Gen. 103.* When Congress passed the Federal Farm Loan Act it had before it reports from agricultural sections to the effect that farmers had been forced to mortgage their properties most detrimental to them, and had been required to pay high interest rates on the loans. In Section 12 of the Act, there was inserted definite restrictions on loans based on first mortgages.

In order to induce the public to invest capital in the Federal land banks and joint stock land banks Congress inserted in Section 26 of the Farm Loan Act a provision exempting first mortgages from any and all taxation. Congress also inserted other provisions in the Act for the purpose of attracting the public to invest capital in the enterprise. And all such provisions, especially the exemption from taxation provision, was a part of the primary plan of giving aid to the distressed condition of farmers.

**The Provision with Respect to Exemption from Taxation of Income from First Mortgages executed to Federal Joint Stock Land Banks is contained in the Federal Farm Loan Act and not under Title II of the Revenue Act of 1921. The Words "Executed" and "Issued" are not Synonyms.**

Considerable thought and discussion is involved in ascertaining the source of exemption from taxation of the interest on first mortgages executed under the Federal Farm Loan Act. Clearly the Federal Farm Loan Act itself (39 Stat. 360, 380) specifically provides that the first mortgages and the income derived therefrom shall be exempt from taxation. *32 Op.*

*Atty. Gen. 54.* But it is argued by defendant's counsel that Section 213 (b) (4), (b) Revenue Act of 1921, also exempts the same interest from taxation. Now in order to be exempt under Section 213 (b) (4), (b) Revenue Act of 1921, it is necessary that the interest must be paid upon "securities *issued* under the provisions of the Federal Farm Loan Act". Accepting the ordinary meaning of words used by Congress, it seems clear that (1) a mortgage is "executed" and not "issued", and (2) Congress used the word "securities" as having reference to "bonds" issued and not "mortgages" executed. These distinctions are what Congress had in mind when they enacted the exemption clause in the Federal Farm Loan Act. Congress said "mortgages *executed*",—not "mortgages issued".

Congress having referred to "mortgages *executed*" and "bonds *issued*" in the Federal Farm Loan Act, it seems desirable to stress the fact that Section 213 (b) (4) (b) uses only one of those terms, viz., securities *issued* under the provisions of the Federal Farm Loan Act.

Therefore, since mortgages are *executed* and not *issued,* Congress did not intend that mortgages were to be classed as "securities".

**None of These Mortgages can Ever be said to be issued. A Farmer's Obligation may total a Million Dollars and Yet he Could Truthfully say That he had Never issued an Obligation.**

In order to fall within the phrase "exempt from taxation under this title" as contained in Section 234 (a) (2), it is necessary to find that Congress, somewhere under that title (Title II), exempted the in-

terest from taxation. The defendant seeks to show that the interest is exempt from taxation under the phrase "securities issued" as contained in Section 213 (b)(4)(b).

We would respectfully point out that Congress, in using the phrase "securities issued", meant exactly what it said, and intended only for the exception to apply to such obligations as are capable of issuance, namely, notes, bonds, certificates, and other negotiable or transferable instruments. For example—

> "The execution and delivery of an instrument or obligation not intended for further circulation by delivery is rarely spoken of as an issue of such instrument." *Lusk v. Stoughton State Bank,* 133 Wis. 311, 115 N. W. 813.

Therefore, when a farmer executes a mortgage to a joint stock land bank, that act creates an express obligation, but that obligation is not issued. Plainly it has never been "issued".

The word "obligation" used in the same Section has as wide if not a wider meaning than the word "securities". While all securities are obligations it seems fair to say that all obligations are not securities. The Board of Tax Appeals, in construing the word "obligation" as used in Section 213 of the 1918 Act, similar to the 1921 Act, stated as follows:

> "Although the word 'obligation' is broad enough to cover the duty resting upon the Government to pay just compensation, we are of the opinion that its application is more restricted under section 213 (b) (4) of the Revenue Act of 1918. We have examined the Congressional Record so far as practicable with respect to all the

acts containing these exemption clauses, but unfortunately we find no expressions upon the part of the legislators which would aid in determining precisely what should be treated as an obligation under the statute. The apparent purpose for exempting from taxation the interest upon obligations of the United States was to facilitate the flotation of low-interest-bearing Government securities, thus partially compensating for the higher interest rates of competitive private issues. The reason for the exemption does not apply to interest on obligations, construing that word in the broad sense for which the petitioner contends." *Kansas City Southern Railway Company v. Commissioner*, 16 B. T. A. 665, 691.

It is therefore submitted that when Congress used the phrase "securities issued" it used it in its ordinary and accepted meaning, and its ordinary usage would not extend to include a mortgage executed by a farmer for the purpose of borrowing money. And certainly if a written contract between a carrier and the Director General does not fall within the term "obligation" it is difficult to see how a mortgage executed would fall within the phrase "securities issued".

**Congress intended that Mortgages executed by the Farmers should, for Taxation Purposes, be treated the Same as if They were Obligations of the United States.**

Admittedly the mortgages executed by the farmers under the provisions of the Federal Farm Loan Act, in fact are obligations of the farmers, but it is equally true that, for taxation purposes, such mortgages should be considered and regarded as obligations of

the United States, for Congress declared that they *"shall be deemed and held to be instrumentalities of the Government of the United States"*.

In other words, while the mortgages in question may not *in fact* be instrumentalities of the United States, nevertheless, for taxation purposes, they "shall be deemed and held" to be such. Now the word "deemed" has acquired a very definite meaning. The Court of Appeals for the Second Circuit in *Douglas vs. Edwards*, 298 Fed. 229, 237, through Mr. Justice Mayer, speaking for the Court, stated:

> "We may dispose at the outset of the meaning of 'deemed'. If it had been intended that this word should mean a rebuttable and not a conclusive presumption, the word 'presumed' could readily have been used, and that is a word which is very familiar in many statutes. 'Deemed', and its synonym, 'regarded' according to definitions in cases and dictionaries, is the equivalent of 'considered' or 'adjudged'. *Leonard vs. Grant*, (C. C.) 5 Fed. 11, 16; *United States v. Doherty*, (D. C.) 27 Fed. 730, 734; *Michel vs. Nunn*, (C. C.) 101 Fed. 423; *Cardinel vs. Smith*, 5 Fed. Cas. 45, 47; *Walton vs. Cavin*, 16 Q. B. 48, 81."

In *Leonard vs. Grant*, 5 Fed. 11, 16, the court on construing the phrase "shall be deemed a citizen", stated:

> "The word 'deemed' is the equivalent of 'considered' or 'adjudged'; and, therefore, whatever an act of Congress requires to be 'deemed' or 'taken' as true of any person or thing, must, in law, be considered as having been duly adjudged or established concerning such person or thing, and have force and effect accordingly. When, therefore, Congress declares that an alien woman

shall, under certain circumstances, be 'deemed' an American citizen, the effect, when the contingency occurs, is equivalent to her being naturalized directly by an act of Congress, or in the usual mode thereby prescribed."

Certainly there are no reasons to deny deductions of the interest in question because Congress in passing the Federal Farm Loan Act, was trying to help and not hinder the farmers. To deny the deduction of the interest paid out by the bank would have the effect of taxing the interest received on the mortgages. On reason alone the interest should be allowed as a deduction. Therefore, since these mortgages are to be treated the same as Government obligations, an analysis of the Act will show that the interest is taken out of the exception of Section 234 (a) (2) of Title II, of the Revenue Act of 1921, by the parenthetical clause "(*other than obligations of the United States issued after September 24, 1917*, and originally subscribed for by the taxpayer)".

That is to say, if a taxpayer pays interest on indebtedness incurred or continued to purchase or carry State, county, or municipal securities, the law provides that such interest may not be deducted, but if the same or another taxpayer pays interest on indebtedness incurred or continued to purchase or carry obligations of the United States issued after September 24, 1917, the interest is deductible. Therefore, since Congress has said that the mortgages executed and the bonds issued under the provisions of the Federal Farm Loan Act "shall be *deemed and held to be instrumentalities of the Government* of the United States" for purposes of taxation, whether Federal, State, or otherwise, such mortgages should be treated as if they were mortgages of the United States.

There is no room for any other construction of what Congress said. If they are not to be treated as if they were obligations of the United States, there would be no purpose of Congress in making such mortgages exempt from State, municipal and local taxes. Congress has very wide powers in such matters, and it was within the province of Congress to declare that, for taxation purposes, these mortgages were to be treated as obligations of the United States are treated, thereby placing them beyond the power of the state governments to levy a tax thereon. Congress had this very thought in mind. It devoted an entire paragraph to the exemption of these securities. It was not just a word—the skin of a thought—but the thought itself.

**Congress never Intended that the Exception Clause of Section 234 (a) (2), Revenue Act of 1921, was to Apply to Joint Stock Land Banks making Loans to Farmers.**

As previously shown, Congress exempted the interest on mortgages from taxation to make the Federal Farm Loan banking business attractive to those with capital to invest. And while the Federal Farm Loan Act clearly exempts the interest of first mortgages from taxation, it is argued by defendant's counsel that since the interest on the mortgages is exempt from taxation the bank may not deduct the interest paid out on its bonds, because of the phrase in Section 234 (a) (2), Act of 1921, reading "the interest upon which is wholly exempt from taxation under this title." In short, defendant's counsel argues that the interest on the first mortgages falls within the phrase "exempt from taxation under this title",

meaning Title II of the Revenue Act of 1921. The only provisions of Title II referring to exemption of interest from taxation is contained in Section 213 (b), which provides that gross income does not include interest upon "*securities issued* under the provisions of the Federal Farm Loan Act of July 17, 1916." That is to say, no matter where the exemption is contained the income is exempt under Title II of the Revenue Act. Argued differently, it is said that if Title II had been completely silent with respect to making interest exempt (thereby leaving the Federal Farm Loan Act as the sole source of exemption) the interest would fall within the phrase "exempt from taxation under this title".

Now, it is right here that we differ with defendant's counsel, for in order that interest be exempt *under* the title means to be exempt with the sanction, authorization or permission of the title. See *32 Op. Atty. Gen. 54.* In Section 231, Revenue Act of 1921, numerous corporations are "exempt from taxation under this title", but a foreign corporation who has no income from sources within the United States is not "exempt under this title" merely because it is not sought to be taxed or specifically made exempt. The foreign corporation not being subject to the income tax law is exempt *from* the title, but not *under* the title.

**The Court Below Erroneously assumes that Joint Stock Land Banks do not Ordinarily have Income Subject to Taxation.**

In the opinion by Judge Williams, of the Court of Claims, it is stated:

"Joint stock land banks, not being permitted to engage in any business, except that of making loans to farmers and issuing their bonds to procure the necessary funds therefor, do not ordinarily have income subject to taxation, and so long as such banks operate as individual and separate institutions, it cannot make the slightest difference whether they have or do not have the right to deduct the interest paid on their bonds. Their income is tax exempt, and consequently the right to make deductions therefrom means nothing."

We submit that the foregoing assumption is erroneous in that joint stock land banks do in fact have taxable income. It is true that the interest received on the loans to farmers is exempt from taxation, but it is equally true that joint stock land banks have income other than interest received on loans made to farmers. This income may arise out of selling property previously acquired under foreclosure proceedings, or out of other transactions entered into within its scope of business. A joint stock land bank, generally speaking, has the same powers and is subject to the same restrictions and conditions imposed upon the Federal land banks. An examination of Section 4 of the Federal Farm Loan Act does not disclose the restrictions as to business undertakings as stated above in the opinion. In fact, in Section 22, a joint stock land bank is specifically authorized to purchase United States Government bonds, which bonds may be sold at a profit taxable under the Revenue Act, although the interest on such bonds is not taxable. And of course there are numerous other ways in which a joint stock land bank may have income. See I. T. 1806 (II-2 C. B. 92) holding that the

net income of Joint Stock Land Banks is subject to Federal income tax.

It is true that the record in the present case does not disclose taxable income on the part of the joint stock land banks, but, nevertheless, the Mississippi Joint Stock Land Bank and the Tennessee Joint Stock Land Bank do have taxable income.

## Conclusion.

The judgment of the Court of Claims should be reversed.

Respectfully submitted,

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